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## JAPAN'S INDUSTRIAL POLICY AND ACCESSION TO THE GATT: A TEACHER BY POSITIVE OR NEGATIVE EXAMPLES?

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### *Abstract*

We examine the lessons to China's accession to the GATT/WTO from Japan's industrial policy and accession to the GATT. The experience of Japan is neatly reviewed, and Japan's industrial policy is briefly characterized with special emphasis on the three roles competition plays in the context of industrial policy formation and implementation. The first role is played in the actual market place, where interfirm competition takes place, the second role is played in the policy forum, where public decision-making on industrial policy takes place, and the third role is played in the jurisdictional dispute, where inter-ministrial competition takes place. The paper then asks the crucial question: What's wrong with bilateral negotiations and dispute settlements outside the GATT/WTO set of rules? Based on these preliminary analyses, several remarks will be made on China's accession to the GATT/WTO regime with special reference to her current industrial policy.

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### I. Introduction

History seldom repeats itself, and it *never* repeats itself exactly. Circumstances and players of the game inevitably change over time, and institutional framework, which stipulates the rules of the game, evolves through historical experience, or changes through deliberate design. These remarks fully apply to the history of the GATT/WTO regime too, yet it may not be altogether unreasonable to enquire if there is any lesson to China's proposed accession to the GATT/WTO from the historical experience of Japan's industrial policy and her accession to the GATT. The purpose of the present paper is to shed some lights on this learning exercise.

Apart from this introduction, the structure of the paper is as follows. In Section II, we

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examine the experience of Japan's accession to the GATT regime in the early 1950s. Although this issue is predominantly a matter of economic diplomacy rather than a matter of industrial policy,<sup>1</sup> Japan's accession to the GATT would have been much delayed to the detriment of national welfare if it had not been for the coordinating role of industrial policy in the domestic arena. Section III is devoted to the brief characterization and critical evaluation of Japan's industrial policy in the broader context. Recollect that industrial policy is designed to improve the long-run economic performance of a nation by intervening in the intersectoral allocation of resources or in the industrial organization of some specific sectors when market failures are caused by such factors as imperfect information, cost of information acquisition, transmission and coordination, Marshallian external economies and dis-economies, and imperfections in risk and capital markets. Industrial policy in this sense had played a substantial role in promoting economic development not only in Japan, but also in Korea and other countries of East Asia.<sup>2</sup> Although the success of industrial policy in these countries does not in any sense guarantee its universal workability and effectiveness, on the one hand, and its transplantability to the foreign soil, on the other, Japan's experience of industrial policy may be useful in identifying the prerequisites for its successful implementation and the GATT/WTO consistency thereof. Section IV focuses on the issue of bilateralism versus multilateralism in dispute settlements. We would like to pose and settle the following question: What's wrong with bilateral trade negotiations and dispute settlements exemplified by voluntary export restraint (VER) and voluntary import expansion (VIE)? Section V presents several remarks on China's industrial policy in the light of our preceding analyses. Section VI concludes with two general observations.

## II. *Japan's Accession to the GATT Regime*<sup>3</sup>

It was in April 1952 that the Peace Treaty of San Francisco as well as the U. S.-Japan Security Treaty came into effect, and Japan thereby recovered independence which she had lost for 7 years after her devastating defeat in the World War II. It was immediately afterwards that Japan applied for the accession to the GATT, but it was not until September 1955 that her accession was officially endorsed. Even then, 14 out of its 34 member countries invoked Article XXXV, thereby preventing a GATT relationship with Japan from taking full effect.<sup>4</sup> Large part of Japan's subsequent economic diplomacy was focussed on urging these 14 countries to withdraw their Article XXXV invocation, which became by far the most pressing issue for

<sup>1</sup> As a partial vindication of this fact, there are only a few brief mention to Japan's accession to the GATT regime in Ministry of International Trade and Industry (1989-94), which is an extensive and "official" history of Japan's Trade and Industrial Policy in the postwar period. See Vol.1 (1994), pp.324-325, Vol.6 (1992), pp.225-246 and Vol.8 (1993), pp.253-259 thereof.

<sup>2</sup> See Amsden (1989), Itoh, Kiyono, Okuno-Fujiwara and Suzumura (1991), Johnson (1982; 1987), Jones and SaKong (1980), Komiya (1975), Komiya, Okuno and Suzumura (1988), Mason, M. J. Kim, Perkins, K. S. Kim and Cole (1980), Ministry of International Trade and Industry (1989-94), Mutoh, Sekiguchi, Suzumura and Yamazawa (1986), Okuno-Fujiwara (1991), Pack and Westphal (1986), Rodrick (1992; 1995), Suzumura and Okuno (1987), Wade (1990), Westphal (Summer 1990), and World Bank (1993), among many others.

<sup>3</sup> Those who are interested in factual details on what we write in this section are referred to Akaneya (1992). See also Ministry of International Trade and Industry (1992, Vol.6, pp.225-246; 1993, Vol.8, pp.253-259).

<sup>4</sup> These 14 countries consisted of Great Britain, France, Netherlands, Belgium, Luxemburg, Austria, Australia, New Zealand, Cuba, Haiti, Brazil, India, the Union of South Africa, and Rhodesia.

Japan under the GATT regime, particularly because many countries subsequently acceding to the GATT also invoked Article XXXV towards Japan.<sup>5</sup>

This situation was quite unusual in several distinct ways. To begin with, among the countries which were defeated in the World War II, West Germany did not meet substantial hindrance to her accession to the GATT, receiving the official GATT membership as early as June 1951. Secondly, Japan's accession to other major international organizations did not encounter comparable objection. For example, West Germany and Japan were simultaneously inducted into the International Monetary Fund (IMF) and the World Bank in August 1952.<sup>6</sup> Thirdly, before Japan's accession to the GATT, there were only 2 preceding instances of invoking Article XXXV, viz., Cuba's invocation against those countries which were restricting sugar imports, and India's and Pakistan's invocation against the Union of South Africa with the diplomatic purpose of protesting against apartheid.

Several questions naturally suggest themselves in this context:

- (1) What were the factors which made Japan's accession to the GATT so unusually difficult, and what were the factors which triggered the massive invocation of the GATT Article XXXV towards Japan at the time of her official accession?
- (2) Despite the fact that there were so many expressed apprehension towards Japan's accession to the GATT, how could Japan be inducted into the GATT *unanimously* at the end?
- (3) What were the crucial factors which motivated Japan to seek for an early accession to the GATT, and what were the costs and benefits of Japan's strenuous pursuit of this economic diplomacy? What role, if any, did Japan's industrial policy play in this pursuit?

On the face of it, the reasoned answer to the question (1) may seem obvious. Unlike the case of IMF, World Bank, ILO and some other international organizations, to which Japan could accede without severe hindrance, Japan's accession to the GATT was feared to set off serious conflict of interests with incumbent member countries, particularly with advanced industrialized countries such as Great Britain, France and Australia. Japan was believed to have strong competitive edge in textile and some other labour-intensive light manufacturing products. The prewar trade performance of Japan, which was widely alleged to have exerted strongly disrupting impacts through "unfair trade practices", did not help either. Particularly in view of the stagnant textile markets worldwide, and accumulating excess capacities in the advanced GATT member countries, there developed a strong apprehension towards Japan's accession to the GATT in general, and her acquisition of the most-favoured nation treatment in particular, which would strengthen her competitive edge even further. Indeed, so strong was this apprehension that there was an attempt orchestrated by Great Britain to introduce a selective safeguard clause into the GATT designed to apply solely to Japan without any

<sup>5</sup> The year in which some of the original 14 member countries finally withdrew their Article XXXV invocation towards Japan is as follows:

Brazil (August 1957), India (October 1958), Cuba (December 1961), New Zealand (March 1962), France (January 1963), Great Britain (April 1963), Australia (May 1964), Belgium, Luxemburg and Netherlands (October 1964).

There are 3 countries which are still preventing a GATT relationship with Japan from taking effect, which are Botswana, Haiti and Lesotho.

<sup>6</sup> In the case of the United Nations, Japan's application for membership in June 1952 was vetoed by the USSR, and it was not until December 1956 that Japan was admitted to the United Nations.

influence on the GATT relationships among all other member countries.<sup>7</sup> It goes without saying that such a selective safeguard provision goes squarely against the basic GATT principles. This attempt, which was made futile by the objection of the American Government, suggests a general problem involved in the accession to the GATT by any country which is somehow perceived “different” from the incumbent member countries. As was aptly observed by John Jackson (1996, p.151):

Many rules of the trading system attempt to minimize government measures which interfere with or distort free-market-economy principles. GATT, of course, was largely based upon such principles. It is not surprising, therefore, that it is often difficult to apply GATT's trading rules to non-market economies. But even among the relatively similar western industrial-market economies, there are wide differences in the degree of government involvement in the economy and in the form of regulation or ownership of various industrial or other economic segments. As world economic interdependence has increased, it has become more difficult to manage relationships among various economies. This problem is analogous to the difficulties involved in trying to get two computers of different designs to work together. To do so, one needs an interface mechanism to mediate between the two computers. Likewise, in international economic relations, particularly in trade relations, some “interface mechanism” may be necessary to allow different economic systems to trade together harmoniously.

Presumably, Japan's accession to the GATT in the 1950s was the first instance in which the GATT member countries were confronted with this problem of interface within the GATT regime.

Needless to say, the bedrock principles of the GATT/WTO regime are the *principle of most-favoured-nation treatment* (Article I) and the *principle of national treatment* (Article III). The former principle prohibits the discriminatory treatment of GATT member countries, whereas the latter principle prohibits the discriminatory treatment of domestic firm (or product) and foreign firm (or product) within the same national boundary. Even when a country, say A, fully abides by these two basic GATT/WTO principles, however, a foreign country, say B, may still feel that she is given a discriminatory treatment in the presence of substantial difference in the domestic rules of the game between A and B. This problem will occur, for example, when a B-firm is subject to the government regulation in the country A which is not applied to an A-firm in the country B. When we confront a situation like this, should we seek for international harmonization of the rules of the game,<sup>8</sup> or should we acquiesce in the inter-country difference of the rules of the game, and leave matters to be settled by competition among institutions? This issue will become particularly acute in the case of China's accession to the GATT/WTO, but it existed already in the case of Japan's accession to the GATT.

A part of the answer to the question (2) should be attributed to extraordinary efforts by those who arduously promoted Japan's accession to the GATT. To say nothing of the Japanese diplomats, the name of Eric Wyndham-White, who was the Director General of the GATT

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<sup>7</sup> See Akaneya (1992, pp.128–131).

<sup>8</sup> See Bhagwati and Hudec (1996) and Takigawa (1997), among many others, for some recent examinations of the proposed international rule harmonizations.

with a strong belief in GATT's principle of non-discrimination and free trade, deserves special mention for his tireless and creative initiatives, without which many deadlocks would not have been circumvented. We should also mention to the strenuous and strong support extended by the American Government throughout Japan's attempted accession to the GATT. It is true that their support was motivated at least partly by the strategic consideration to the effect that rejecting Japan's accession to the GATT might bring about a deplorable consequence of alienating Japan from the Western allies and pushing her towards China. A strategic consideration such as this was found forceful during the cold war era, which was also shared by some of the incumbent GATT member countries including Great Britain and Australia. It goes without saying that this shared strategic perception was one of the reasons which motivated some of the incumbent GATT member countries to refrain from casting a negative vote to Japan's accession in the end. It seems to us, however, that this is only one side of the coin.

To understand the other side of the coin, recollect that there are two distinct faces of the GATT. The first face is that it is *a set of rules* for promoting and monitoring efficient and equitable world trade system, which is characterized by *free trade*, *multilateralism in dispute settlements*, and the principle of *non-discrimination*. The second face is that the GATT is a *practical organization* which is geared towards promoting national welfare of each and every member country through world trade. The former is a characterization of the GATT from the *procedural* viewpoint, whereas the latter is a characterization thereof from the *outcome-oriented* viewpoint. Referring to this dual characterization of the GATT, we may suggest that the incumbent GATT member countries respected their joint prior commitment to the GATT as a set of fair procedural rules, and voted for Japan's non-discriminatory accession to the GATT, even though the immediate consequences of Japan's accession were expected to act to their disadvantage.<sup>9</sup> The massive invocation of the GATT Article XXXV was nothing other than an emergency measure to safeguard against the short-run negative consequences of their good cause. Such an emergency measure had to be invoked by default for the lack of better

<sup>9</sup> It may well be asked further why we should emphasize the role played by Wyndham-White and others who promoted Japan's accession to the GATT if the incumbent GATT member countries were in fact prepared to respect their commitments to the procedural rules of the GATT. To answer this question, suppose that there are two incumbent member countries  $\alpha$  and  $\beta$ , each of which has two options  $f$  and  $a$ , where  $f$  denotes the strategy "to vote for Japan's accession", and  $a$  denotes the strategy "to vote against Japan's accession". In the presence of the commitment to the GATT norm, it seems not unreasonable to suppose that the countries  $\alpha$  and  $\beta$  have the following preferences over the set of possible outcomes, which consists of  $(f, f)$ ,  $(f, a)$ ,  $(a, f)$  and  $(a, a)$ , in the descending order of preference from the left to the right:

$\alpha$ :  $(f, f)$ ,  $(a, f)$ ,  $(a, a)$ ,  $(f, a)$

$\beta$ :  $(f, f)$ ,  $(f, a)$ ,  $(a, a)$ ,  $(a, f)$ ,

where, for example,  $(f, a)$  means that  $\alpha$  votes for Japan's accession and  $\beta$  votes against Japan's accession. The intended meaning of this preference profile is that each and every incumbent country is willing to vote for Japan's accession if the other country does the same, but both countries are unwilling to sacrifice their short-run benefits unilaterally if otherwise.

It is clear that this game, which is called the Assurance Game by Amartya Sen (1982, pp.78-83), has two Nash equilibria, viz.,  $(f, f)$  and  $(a, a)$ . Depending on how each country expects what strategy the other country is going to use, one or the other equilibrium will materialize. It is in this context that the role of promoter becomes relevant. If only each and every country is assured that the other country is going to respect her commitment to the GATT norm and chooses the strategy  $f$ , the equilibrium  $(f, f)$  is going to be realized, but otherwise the equilibrium  $(a, a)$  must appear by default.

interface mechanism within the GATT procedural rules. It deserves emphasis that this joint commitment to the agreed-on set of procedural rules is the ultimate stabilizer of the GATT/WTO regime, and it is the duty of any inductee to abide by this code of action.

The dual nature of the GATT is also relevant in trying to find an answer to the question (3). It is undeniable that Japan's accession to the GATT was primarily sought for in order to secure a better outcome in tariff concessions by the GATT member countries, especially in the area of textiles.<sup>10</sup> In view of the conspicuous fact that the original 23 GATT member countries accounted for more than 80% of the world trade, it was felt to be of crucial importance for Japan to accede to the GATT and to obtain non-discriminatory treatment in world trade in general, and most-favoured nation treatment in particular. It is true that this purpose could have been attained in principle through a succession of bilateral negotiations outside the GATT regime, but it was felt unlikely that Japan could secure fairer treatment in bilateral negotiations outside the GATT than in multilateral negotiations under GATT's procedural rules. Thus, Japan's accession to the GATT was recognized as a quantum step towards acquiring procedural fairness in trade negotiations.

Needless to say, there were something to be sacrificed in exchange if Japan was to seek for accession to the GATT. For one thing, Japan would be handcuffed by her GATT membership status in pursuit of her industrial policy objectives such as promotion and/or protection of industries of strategic importance. For the other, to benefit from the tariff concessions by incumbent member countries through most-favoured-nation treatment in the GATT, Japan would surely be required to propose substantial tariff concessions of her own.<sup>11</sup> It is no exaggeration to say that an important and irrevocable industrial policy decision was made in effect when the potential benefits from the GATT membership was judged to outweigh the expected costs thereof. Since the benefits and costs spread unevenly over many domestic industries and other stakeholders, this overall collective decision cannot but mean that industrial policy played a crucial coordinating role in the domestic policy arena, thereby complementing Japan's most important economic diplomacy in the postwar period.

Judging from the fact that Japan became the largest beneficiary of the GATT regime, this policy choice seems to be well justified *ex post*.

### III. *Anatomy of Japan's Postwar Industrial Policy*

Suspicious attention has been focussed on Japan's postwar industrial policy, which is widely perceived as anti-competitive in substance, and unfair and intransparent in procedure. Unfortunately, this suspicion is not altogether without reason.

Immediately after Japan regained independence in April 1952, revisions which were meant to neutralize some impacts of postwar economic reforms implemented under the

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<sup>10</sup> See, among others, Akaneya (1992, p.86).

<sup>11</sup> In the 8th General Assembly of the GATT which discussed Japan's provisional accession to the GATT, the Japanese Government circulated a plan of sub-division of Japanese tariffs into bound and unbound positions in connection with its proposal of provisional membership. Under the condition that all the contingent GATT member countries would enter into the GATT relationship with Japan, it was announced that Japan was prepared to make tariff concessions on 91.8% of all articles, which occupied 85% of Japan's import values in 1952. See Akaneya (1992, p.198).

supervision of the Occupation Authorities were enforced.<sup>12</sup> In particular, the 1953 revision of the Anti-Monopoly Law legalized depression cartels and rationalization cartels, and severe restrictions on stock retention by corporations, interlocking directorships and mergers, which were clearly stipulated in the original Anti-Monopoly Law of 1947, were substantially relaxed. Furthermore, and even before the 1953 revision of the Anti-Monopoly Law, the Ministry of International Trade and Industry (MITI) had introduced the notorious scheme of administrative guidance in the form of advisory curtailments in the textile industry. In view of these anti-competitive modifications to the postwar reforms, coupled with the frequent use of administrative guidance whose legal foundation is unclear and the procedure thereof is intransparent to say the least, it is understandable that a view came to acquire a great vogue, according to which MITI as helmsman of Japan's industrial policy had firm control over industries through administrative guidance, and could almost always and almost everywhere outmaneuver Fair Trade Commission (FTC) in charge of competition policy. The purpose of this section is to rectify this view on the government-business relationship in Japan with the purpose of locating the role of industrial policy in a proper perspective. In particular, we would like to substantiate the following two major points:

- (1) Competition, rather than MITI's anti-competitive regulation, had been the prime engine of growth in the postwar Japan;
- (2) The formulation and implementation of industrial policy were not within the exclusive control of MITI, or any other government agency for that matter. To the contrary, they were conducted through a collaborative mechanism in which government bureaucrats, industry representatives, and private and government banks all participated, exchanged information, and negotiated with each other.

In the context of industrial policy formation and implementation, competition plays vital roles in three distinct arenas. The first arena is the actual market place, where interfirm competition takes place. The second is the policy forum, where the public decision-making mechanism for industrial policy formation and implementation is set in motion. The third is the jurisdictional dispute between government ministries, where inter-ministrial competition takes place. Let us pay a brief visit to these arenas in turn.

Recollect that the task of industrial policy is not to substitute for, but to complement with the competitive market mechanism if and where market failures occur. Thus, interfirm competition in the market place should not be interfered with, unless there is a recognizable cause of market failure, and the guiding principle of industrial policy in developing market economies and economies in transition should be to make the maximum use of competitive market forces by freeing private incentives from bureaucratic paternalism as much as possible. However, there is a long-standing tradition in Japan which strenuously alleges that one of the persistent failures of Japan's competitive market mechanism is precisely its robust tendency

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<sup>12</sup> During the occupation period (1945–1952) in the postwar Japan, a series of economic reforms aimed at Japan's democratization were implemented under strong order and control of the Occupation Authorities. These reforms, which include the *zaibatsu* (family-dominated combines) dissolution and elimination of excessive concentration in production as well as property ownership in general, the transplantation of the US Antitrust Law into Japan (Anti-Monopoly Law of December 1947), land reform and labour democratization, undoubtedly shaped the basic competitive framework of the postwar Japan. See Komiya, Okuno and Suzumura (1988) and Teranishi and Kosai (1993) for details about these postwar economic reforms.



towards *excessive competition*. For those who are well-accustomed to the orthodox theory of welfare economics and industrial organization, according to whose doctrine competition is precisely the efficient allocator of resources, the very term, excessive competition, would sound dubious. However, recent studies in theoretical industrial organization revealed that there is a clearly definable sense in which market competition *can* become socially excessive.<sup>13</sup> Thus, this plea for government intervention cannot be exorcised so easily.

At this juncture, it is useful to note that the actual intervention in the postwar Japan in the name of keeping excessive competition under control was implemented through allocating, for example, import quotas or mandatory authorization of new productive facilities in such a way as to assign priority to firms according to their rank-order in terms of some simple indices of productive capacity or market share.<sup>14</sup> The upshot of using this rule of thumb for the purpose of controlling competition through regulation was remarkable. Instead of keeping excessive competition, so-called, under due public control as intended, this practice aggravated the situation by motivating firms to expand their productive capacity or market share beyond the level justified by prevailing market conditions in the hope of securing favourable treatment by the government officials in future rounds of allocating these privileges. Thus, "that productive capacity has actually been used or referred to for administrative or allocative purposes in direct controls, administrative guidance, or cartelization, and that companies rightly or wrongly expect this to be repeated in future, seem to be the real cause of the 'excessive competition in investment' [Komiya (1975, p.214)]."

Before leaving this first arena, a final remark may be in order. As Avinash Dixit (1984, p. 15) aptly observed, "vested interests want protection, and relaxation of antitrust activity, for their own selfish reasons. They will be eager to seize upon any theoretical arguments that advance such policies in the general interest. Distortion and misuse of the arguments is likely, and may result in the emergence of policies that cause aggregate welfare loss while providing private gains to powerful special groups." This warning applies squarely to the argument in favour of regulation of excessive competition. It is in fact an irony of history in the postwar Japan that interfirm competition was never effectively controlled by regulatory intervention, and it functioned as the prime engine of growth. Indeed, as was forcefully pointed out by Takafusa Nakamura (1995, p.51), government's promotion of depression cartels, rationalization cartels and other attempts to control competition "meant no more than that firms were able to find some shelter during economic downturns; [they] never acted as a general restriction on competitive conditions in the markets formed after the war. On the contrary, secure in the knowledge that relief was available, firms adopted bold strategies and competition became all the more vigorous."

Let us now turn to the second arena, viz., the policy forum where the public decision-making mechanism for industrial policy formation and implementation functions. It is worthwhile to recollect that, even when an industrial policy can be justified *in principle*, there is no assurance that such a legitimate industrial policy lies within reach of the actual

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<sup>13</sup> See, among others, Suzumura (1995).

<sup>14</sup> Apart from its easy enforceability due to the simplicity of informational requirement, this rule of thumb to the effect of *remunerating each agent in proportion to his/her past accomplishment* has an intuitive appeal with an equitable flavour, so that it is rather hard to argue against its application. This was presumably the reason why Japanese government officials took recourse to this rule of thumb in their regulatory practice.

*second-best* government.<sup>15</sup> For lack of accurate information and for lack of ability to understand the causes and consequences of market failures, the real problem to be faced by the second-best government is never that of *constrained optimization of a given social objective*, the solution to which is the *first-best* industrial policy. To the contrary, the problem for the second-best government is that of designing and implementing a collaborative mechanism for information exchange, coordination, and dissemination, through which diverse and conflicting objectives of private agents and government officials are adjusted and made compatible, and voluntary compliance by all parties involved is eventually secured. This is no simple task. Making this task even more difficult is the ultimate cause of government failures, viz., human fallibility. Government interventions inevitably favour some industries and disfavour others, so that there is always potential room for corruptions, opportunistic behaviour, and rent-seeking activities with a result that the government-assisted market economies may ultimately perform worse than *laissez faire* which is vulnerable to market failures.

In the context of Japan's postwar industrial policy, which is surely that of the second-best, how could these problems be coped with? Part of the answer seems to lie in the fact that a collaborarative mechanism for exchanging, coordinating, and authorizing activity plans of various industries were meticulously developed for the purpose of implementing the second-best industrial policy, in which government bureaucrats, industry representatives, private as well as government banks participated, exchanged information, and negotiated with each other. It was through this interactive coordination mechanism that reliable information on the direction of industrial policy initiatives as well as the macroeconomic constraints which the economy was facing were effectively disseminated and shared, thereby motivating and helping private firms to adjust and coordinate their plans and expectations. The possibility of manipulation of this coordination mechanism through false information submission could be effectively checked by the expertise of the banking sector and technocratic bureaucrats. It was clearly understood by all parties involved that this game would be repeated sufficiently many times, and the attempt to squeeze out private gains in the short-run through strategic manipulation of this mechanism would vitiate one's reputation in the long-run beyond rectification. It was precisely this systemic device which left little room for strategic manipulation of the coordination mechanism for private gains in the short-run.<sup>16</sup>

This cannot be the end of the story, however. The more we emphasize the role of collaborative mechanism for information exchange, coordination and sharing, the more we are exposed to further questions like the following:

- (1) Collaborative behaviour among competitive firms may prepare the stage for collusive behaviour among them to the detriment of social welfare. How could this subtle and dangerous shift from collaboration to collusion be detected and contained?
- (2) Collaboration among competitive firms may easily dull the edges of their competitive swords, and may even inhibit effective competition itself, leading to managerial slack, or a more general loss of economic efficiency. How could this foreseeable danger be alleviated and harsh interfirm competition be maintained?

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<sup>15</sup> More details on this and succeeding points are available in Itoh, Kiyono, Okuno-Fujiwara and Suzumura (1991, Chapter 1), and Malinvaud, Milleron, Nabli, Sen, Sengupta, Stern, Stiglitz and Suzumura (1997, Chapter 6).

(3) Frequent and informal negotiations and persuasions among government bureaucrats and men in business may pave the road towards encouraging firms to seek favours from government bureaucrats in exchange for pecuniary and/or non-pecuniary compensations. How could this easy progression to corruptions be blocked?

It seems to us that an important ingredient of our reasoned answer to these questions takes the following form: The institutional structures were deliberately developed so that firms participating in the collaborative mechanism had to *contest* with each other for *prizes* in the form of preferential access to favourable tax/subsidy measures, permission of international know-how contracts and/or exclusive import licenses. Examples of such contest-based competition abound in the postwar Japan and some other highly performing economies in East Asia.<sup>17</sup> The most widely applied contests were export contests for the favourable access to credit and foreign exchange. Likewise, the government's authority to grant licenses to those firms that complied with government policy was invoked to generate contest-based competition among firms. It was these contest-based competition among firms participating in the collaborative public mechanism that effectively prevented the occurrence of inefficiency and favouritism. Put differently, even within the context of a collaborative mechanism for coping with market failures, the key word is, again, competition. In short, in the *absence* of market failures, it is the *market-based competition* that plays the crucial role, whereas in the *presence* of market failures, it is the *contest-based competition* within the collaborative public mechanism that plays the crucial role.<sup>18</sup>

It is obviously important for the successful implementation of second-best industrial policy that the nation has a well-organized, highly disciplined, and sincere group of govern-

<sup>16</sup> Historically speaking, it was the American Occupation Authorities who strongly encouraged participatory democracy in order to reduce and rectify the arbitrary nature of the prewar administration in Japan. With the implementation of the National Administrative Organization Law in 1949, the ministries began to establish advisory bodies on the levels of their cabinet ministers, bureau chiefs, and section chiefs. These bodies are classified into *consultative bodies*, which deliberate on policies, and *examining bodies*, which, by participating in administrative decision-making, ensure that laws are fairly administered. A report submitted by a consultative body is not legally binding, whereas the resolution of an examining body can act as a formal constraint on bureaucracy. Thus, examining bodies are far stronger than consultative bodies in terms of their degree of independent authority.

A scheme of utilizing deliberation councils on major policy matters has gradually evolved in the postwar Japan. These are consultative bodies whose deliberations are referred to in the process of policy formation. The members of these bodies are private agents including former bureaucrats, and they are formally nominated by the Minister in charge. The majority of these members are industry leaders, corporate executives, and former bureaucrats with a small number of scholars (academics) and journalists (from newspapers) being included. To the extent that these members are nominated by government bureaucrats, a danger inherent in this public decision-making mechanism is that not only the agenda, but also deliberation process and final conclusion are almost completely controlled by government bureaucrats to the extent that the mechanism may turn out to be a process for rationalizing what the bureaucrats intend to pursue anyway, rather than a forum for sincerely gathering public opinion through open discussion. See Suzumura (1996) for a case study of the *modus operandi* of this public decision-making mechanism in the context of telecommunications reform.

<sup>17</sup> See, also, Amsden (1989), Johnson (1982), Wade (1990), and World Bank (1993).

<sup>18</sup> This is surely not to say that there were no government and political corruptions in relation to the implementation of industrial policy in the postwar Japan. The most controversial corruption case was the ship-building bribery case which broke out in as early as 1954. Presumably, it was in response to the dangerous possibility of rent-seeking activities and corruptions which unambiguously came to the fore due to this notorious bribery case that the sophisticated system of checks-and-balances, that was meant to minimize the room for these aberrations, was subsequently developed.

ment bureaucrats as helmsman of industrial policy. It makes sense, however, if a well-designed and well-managed public mechanism for implementing industrial policy exists in which private agents and government agents iteratively interact, that is robust enough to ward off the potential danger of rent-seeking activities, opportunistic behaviours, strategic manipulations, and bureaucratic corruptions. Implementation of second-best industrial policy is a serious business with much at stake, and it is advisable to avoid putting all of the eggs in one basket.

As Ryutaro Komiya (1975, p.221) observed:

Whatever the demerits of the system of industrial policies in postwar Japan, it has been a very efficient means of collecting, exchanging and propagating industrial information. ... Probably information related to the various industries is more abundant and easily obtainable in Japan than in most other countries. Viewed as a system of information collection and dissemination, Japan's system of industrial policies may have been among the most important factors in Japan's high rate of industrial growth, apart from the direct or indirect economic effects of industrial policy measures.

The third and last arena is the jurisdictional disputes between government ministries, where inter-ministrial competition takes place. Generally speaking, jurisdictional disputes may be the most significant events in the lives of bureaucrats, and their effect on government efficiency has two sides. On the one hand, competition among ministries can serve as a check-and-balance mechanism, and can be a source of dynamism and creativity for government bureaucracy. On the other hand, they may lead to irresponsible opportunism and coordination failures among government policies, which bring about regrettable consequences for national welfare. This general tendency is magnified in Japan, as there exists a one-to-one correspondence between an industry and the ministrial bureau, division, or section, under whose jurisdiction it falls. Whenever there is a development that disrupts or blurs this finely balanced relationship, a jurisdictional dispute inevitably breaks out. It is no wonder that such disputes abound in Japan.

A concrete case in point is a jurisdictional dispute that broke out between the Ministry of Posts and Telecommunications (MPT) and MITI, which is often construed as one of the most conspicuous examples of jurisdictional disputes in the postwar Japan, and the peak thereof was in 1983-85 during the so-called *Telecom Wars*. As was acutely pointed out by Takao Kawakami (1985, pp.61-62), a computer without software is only a box, and a computer with software is still only a computer. But a computer (with software) connected to a telephone circuit becomes a different creature altogether: it becomes a telecommunications network. Since computers belong to MITI's jurisdiction, whereas telecommunications belong to MPT's jurisdiction, it is no wonder that a head-on clash inevitably developed as computers came to be widely connected to telephone circuits and generated new data communications services.

For our present purpose, it is not much of use to pursue this particular jurisdictional dispute in detail.<sup>19</sup> We have only to note that it is often through such a dispute that we come to understand the real issue involved in the public policy debate better than otherwise, thereby improving awareness of the importance of public decision-making in question. Another social value of jurisdictional dispute is that government ministries involved in such a dispute must

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<sup>19</sup> See Suzumura (1996a) for a detailed analysis of Japan's industrial policy in telecommunications and the role of jurisdictional dispute between MPT and MITI in that context.

improve the accountability of their policy stance, thereby improving the transparency of government ministries and their policy stance.

We have thus shown that competition plays vital roles within the context of industrial policy formation and implementation in three distinct arenas. The economic mechanism of Japan may be different from some of the advanced market economies in certain important respects, but it is far from reality to characterize it as an anti-competitive mechanism under monolithic control by MITI's industrial policy. It is true that many formal and informal measures for controlling competition were introduced in the postwar Japan.<sup>20</sup> In addition to the 1953 modifications of the Anti-Monopoly Law which explicitly legalized some anti-competitive practices, several other measures existed that could be invoked by the government to regulate competition. These measures, which included public utility regulation, licensing for maintaining health and safety standards, and protection of a specific industry such as agriculture, enabled the government to interfere directly in an industry by entry regulation, price regulation, or both. It is also clearly true that "[t]he Japanese economic bureaucracy has long found that its most effective powers are tailor-made, verbal, ad hoc agreements implemented through 'administrative guidance' [Johnson (1987, p.159)]."<sup>21</sup> So effective and convenient was this power that it was only in 1993 with the enforcement of the *Administrative Procedure Law* that the opportunity to rectify the discretionary application of administrative procedures was officially opened in Japan.<sup>22</sup> However, these valid observations do not change the fact at all that it was not these anti-competitive regulations *per se*, but competition in the identified three arenas that should be regarded as the prime engine of growth in the postwar Japan.

In concluding this section, let us make a speculative observation on the cultural relativism of competition.<sup>23</sup> There exists a clear distinction between insiders and outsiders in the

<sup>20</sup> For an extensive survey of these measures, see Suzumura (1995a).

<sup>21</sup> In contrast, in South Korea, "[t]he hand of government reaches down rather far into the activities of individual firms with its manipulation of incentives and disincentives." During the Park Chung Hee regime, which started with the military coup of May 16, 1961 and ended with the assassination of the President Park on October 26, 1979, "[a] firm that does not respond as expected to particular incentives may find that its tax returns are subject to careful examination, or that its application for bank credit is sturdiously ignored, or that its outstanding bank loans are not renewed. If incentive procedures do not work, government agencies show no hesitation in resorting to command backed by compulsion. In general, it does not take a Korean firm long to learn that it will 'get along' best by 'going along.' Obviously, such a system of implementation requires not only cooperation among the various government agencies that administer compliance procedures but continuous consultation between firms and public officials. Such a system could well be subject to corruption, and there is some evidence that payments are, in fact, made and received for services rendered, but again it must be emphasized that there is very little evidence that such corruption ... interferes in any serious way with production processes [Mason *et al.* (1980, p. 254, p.265)]." See, also, Jones and SaKong (1980), Rodrick (1992) and Westphal (1990) on this and related points.

<sup>22</sup> With the implementation of this law, it became obligatory for the government bureaucrats in charge of administration to define transparent standards and procedures for administrative guidance. It is also stipulated in this law that persons, to whom administrative guidance is addressed, are in the legal position to request that the guidance be given in the form of official document which specifies the purpose of the guidance and name of the bureaucrat(s) to be held responsible for that guidance. Whether this law will bring about more transparent and less arbitrary government administration is yet to be seen, but it surely testifies to the wide range of administrative discretion which existed before the implementation of this law. Note, however, that "[a]dministrative guidance ... is obviously open to abuse and has been abused on occasion, but it is also much faster than the rule of law and avoids the unpredictable impact of new legislation and court decisions on sectors that do not require adjustment but that are affected anyway because of the universal scope of laws [Johnson (1987, p.160)]."

<sup>23</sup> This observation and the term, *fractal structure of competition*, were first introduced in Suzumura (1996).

perception of some Japanese corporations as well as bureaucrats, and insiders band together against outsiders so as to protect and promote their common interest as far as competition between insider group and outsider group is concerned. However, members within the insider group may engage in fierce competition in other arena. Besides, the boundary that separates insiders and outsiders is anything but fixed, and the insider-outsider demarcation changes flexibly in accordance with the way the competitive arena is circumscribed. Thus, corporations within a specified industry compete fiercely with each other under "usual" circumstances, but they may form a business association (with or without the auspices of the ministerial bureau, division, or section under whose jurisdiction the industry falls) so as to protect and/or promote their common interest against other industries. Even within a corporation or ministry, there exist factions which compete with each other for control over the organization in question, but they unite power to compete effectively with outsider corporation or ministry. Each member of a faction within a corporation or ministry takes part in rank-order competition with other members, but the faction behaves monolithically against other factions. This multi-layered structure of competition and cooperation in Japan may be called the *fractal structure of competition*.

In the presence of this fractal structure of competition, how the insider-outsider demarcation is decided depends crucially on how the competitive arena is specified. When the competitive arena is broadly (or narrowly) circumscribed as in the context of international competition for high-technology products (or intra-firm competition for employee promotion), there may well be orderly cooperation among otherwise competing firms with the shared purpose of competitive survival in international arena (or rat race among candidates without restraint). If this observation is correct at least to some reasonable extent, it may explain some perceptions that competition with Japan is "different".

#### IV. *What's Wrong with Bilateral Trade Negotiations and Dispute Settlements?*

Designed to cope with trade frictions triggered by "excessive" and "disrupting" exports from Japan, formal voluntary export restraints (VER) agreements had been concluded on a large number of manufactured goods in the postwar period. In the wake of a rapid increase in exports of cotton products in the 1950s, temporary voluntary restraints on the Japanese exports to the United States were introduced. These export-import controls on textile products were gradually formalized and came to cover a large number of countries besides Japan and the United States, and international trade in textile products came to be carried out within the framework of Multi-Fiber Arrangement (MFA), which is an international arrangement to manage textile trade. It is this mechanism which has not only blocked export opportunities for developing countries, but also delayed industrial adjustments in developed countries. Managed trade in iron and steel was introduced in the late 1960s in response to a rapid increase in exports from Japan. Although in a modified form, this measure had been in place subsequently, and indications of further strengthening and continuation of managed trade could be found in the extension of such trade-restricting measures in the automotive and integrated circuits industries. As managed trade came to spread to more and more industries, the system of free trade, meticulously built up in the postwar world arounds the GATT regime, was on the verge

of breaking down completely. It was in view of this gloomy prospect that these grey trade-restricting measures came to be prohibited under the GATT/WTO Safeguard Agreement.

This brief description suffices to show that Japan is clearly responsible for the proliferation of bilateral trade negotiations and subsequent bilateral agreements for dispute settlements outside the GATT's set of rules. It is true that Japan has now made a firm commitment to distance herself from bilateral negotiations and agreements outside the GATT/WTO dispute settlement mechanism, but it is important to be absolutely clear about what's really wrong with bilateral trade negotiations and dispute settlements outside the GATT/WTO rule in order to protect ourselves against any danger of future reversion to the wrongful past. The purpose of this section is to crystallize the reasons why it is of crucial importance to avoid any further commitment to bilateralism.

To make our point unambiguously, let us focus on the welfare implications of a VER agreement between two countries. Recollect that a VER is a trade-restricting device which is introduced at the request of the government of the importing country, and is accepted by the exporting country so as to forestall other trade restrictions. It is clearly a highly costly protective measure from the viewpoint of the importing country. Indeed, a VER is a variant of an import quota, where license is assigned to foreign exporters rather than to domestic importers.<sup>24</sup> Thus, a natural question immediately suggests itself: Why can this costly form of bilateral agreement be requested by the government of importing country in the first place, and why should it be accepted "voluntarily" by the exporting country? The answer is simple, yet it is depressing enough.

To begin with, by agreeing "voluntarily" to a VER arrangement, the foreign country may secure rents, that would otherwise remain in the importing country. Secondly, domestic producers, who would otherwise have to face challenges from foreign exporters, are protected by the VER-induced cartel, and can reap extra profits from the domestic price increase. Foreign exporters can also entertain this increase in profits through the domestic price increase. Thus, both domestic producers and foreign exporters are able to increase their profits simultaneously *at the cost of an overwhelming decrease in domestic consumers' benefit*. This is why a VER arrangement, being eagerly promoted by domestic producers with sharply concentrated interest, is agreed to in complete neglect of domestic consumers' loss, which is thinly spread over a large population.<sup>25</sup> This is strongly reminiscent of an insightful observation by Vilfredo Pareto (1927, p.379) to the following effect:

A protectionist measure provides large benefits to a small number of people, and causes a very great number of consumers a slight loss. This circumstance makes it easier to put a protectionist measure into practice.

It is for this reason that VER arrangements, and their import-side counterpart, VIE arrange-

<sup>24</sup> Instead of requesting a VER agreement, the importing country could use a tariff or import quota that would limit imports by the same amount. If these alternative import-restricting measures were invoked, rents earned by foreign exporters under VER would remain in the importing country either as tariff revenue or import license fee.

<sup>25</sup> The validity of this simple reasoning can be easily verified in terms of a simple theoretical model. Indeed, Suzumura and Ishikawa (1997) showed the following remarkable result: *In an international duopoly with product differentiation, where domestic firm and foreign firm compete in terms of prices, a VER imposed at the free trade equilibrium level of exports cannot but decrease domestic welfare.*

ments, are presumably the worst forms of protectionism.

Even if one is a fully devoted *consequentialist* who is exclusively interested in the *outcomes* or consequences of a policy and nothing else, this simple observation may suffice to make one have a second thought on the use of a VER arrangement. However, in addition to this *consequentialist* — actually a *welfaristic* — criticism against the bilateral VER agreement, there is a *non-consequentialist* or *procedural* criticism which adds a serious doubt on the legitimacy of bilateral trade restrictions as a measure for international conflict resolution. More often than not, bilateral agreements are prepared and conducted in complete neglect of the third parties that have no way of representing themselves in the *procedure* through which such bilateral agreements are designed and implemented. This is the case even though the third parties would most likely be affected by spillover effects. Furthermore, this problem would not be alleviated at all even when the nature of bilateral agreements are such that the third parties could equally enjoy the beneficial *outcomes* of bilateral agreements in full accordance with the most-favoured-nation treatment which is stipulated in the GATT/WTO agreements.<sup>26</sup> As Sir Isaiah Berlin (1969, pp.15–16) aptly put it, “[t]he desire to be governed by myself, or at any rate to participate in the process by which my life is to be controlled, may be as deep a wish as that of a free area for action, and perhaps historically older.” Recent proliferation of bilateral arrangements outside the GATT/WTO dispute settlement mechanism are deeply lamentable, as they tend to deny this innate desire to the third parties that are left outside the bilateral negotiation procedure.

Needless to say, the problematic nature of bilateralism becomes even more serious when it is enforced by means of unilateral aggression and/or excessive extra-territorial applications of domestic laws.<sup>27</sup>

### V. Remarks on China's Industrial Policy with Reference to Accession to the WTO

What lessons to China, if any, can we extract from Japan's experience of industrial policy and accession to the GATT? Where can Japan qualify as a teacher by positive examples, and where else should Japan be recognized as a teacher by negative examples? To answer these questions is a task with no mean difficulty, but the answer in abstract terms is rather simple to summarize.

As we have already observed in this paper, the GATT/WTO represents a set of rules which is characterized by three procedural features, *viz.*, *free trade*, *multilateralism in dispute*

<sup>26</sup> For an argument which tries to justify bilateralism along the line we are arguing against in the main text, see Garten (1995), among many others. Jeffrey Garten served as the US Under Secretary of Commerce for International Trade until October 1995.

<sup>27</sup> This is not just a theoretical possibility which is conceivable but improbable. Quite to the contrary, it is a real threat to the basic structure of the GATT/WTO rule, *viz.*, free trade, multilateralism, and non-discrimination. See Industrial Structure Council (1994, Position Paper on Numerical Target-Based Trade Policy, pp.A77–A97), Industrial Structure Council (1995, Position Paper on Direct Requests by Foreign Governments for Japanese Enterprises to Purchase Foreign Products, pp.401–408), Industrial Structure Council (1996, Issues Regarding the Extension of the Japan-U.S. Semi-conductor Arrangements, pp.374–379), and Industrial Structure Council (1997, Results of the 1996 Japan-U.S. Talks Concerning the Semi-conductor Arrangements, pp.319–326) for repeated attempts to impose numerical export-import target to Japan by means of unilateral measures.



*settlements*, and *non-discrimination*. By seeking for the membership of the GATT/WTO, the country is bound to make her economic system basically compatible with this set of rules as a minimal commitment to be made in advance, even if doing so may accompany short-run national disadvantage.<sup>28</sup> The country should also be ready to share the burden of upholding the GATT/WTO regime after accession, even when doing so may go occasionally against her short-run national advantage. It is clear that these two prerequisites may be difficult to satisfy when the country in question is "different" from the incumbent member countries in some important respects. This difficulty may be multiplied by the conspicuous lack of robust interface mechanism within the prevailing GATT/WTO set of rules, which would enable different economic systems to participate in the same trading system harmoniously. However, these difficulties do not seem unsurmountable, as the payoff from China's accession is very high, not only for China herself, but also for the incumbent member countries. Indeed, China's accession will set the stage for further expansion in trade and investment through a reduction in the tariff barriers, and also through the fact that China's trading system will be brought into full conformity to the GATT/WTO rules. Besides, future trade frictions and disputes with China will be processed and settled by the GATT/WTO dispute settlement mechanism which is procedurally fair and transparent. In view of these large gains, which both China and the incumbent member countries can expect to entertain, the real problem is not *if* China can accede to the GATT/WTO regime, but *when* China will be inducted to the full membership.

This optimistic perspective notwithstanding, there are still many hurdles to be surmounted, as there are large gaps between China's current degree of conformity to the GATT/WTO rules which the incumbent member countries are requiring as a prerequisite for China's accession and what China herself is willing to offer.<sup>29</sup> Some of the conspicuous cases in point can be listed as follows:

### (1) Trading Rights

The *trading rights* are the rights to engage in export and import businesses in China, which are conferred only to a few *licensed* companies. This permit system acts as an effective ban on foreign companies to engage in trade, and represents the highest entry barrier into the Chinese market. It is clear that the GATT/WTO rule of national treatment is conspicuously violated by such an asymmetric treatment of domestic and foreign companies, as well as by a discriminatory treatment of imports and domestic products. Through a series of recent consultations and negotiations at the Working Party Meetings on China's accession to the GATT/WTO, China has made a commitment to phase out the restrictions on entry into foreign trade for both domestic and foreign firms within three years of entry to the GATT/WTO. The restrictions on trading rights for goods subject to designated trading are also to be

<sup>28</sup> To avoid possible misunderstanding, it is worthwhile to emphasize that the plea for making a country's economic system basically compatible with those of the incumbent member countries does not mean that the country seeking for accession to the GATT/WTO is under the unilateral obligation to harmonize her economic system with that of the incumbent member countries. It just means that the country's industrial policy should be designed and implemented in such a way as to be in basic harmony with the GATT/WTO procedural rules. This point will be made clearer when we comment on China's industrial policy in more concrete contexts.

<sup>29</sup> Factual details which underlie the following general remarks are spelled out in Industrial Structure Council (1997, Issues Regarding Accession of China, Taiwan and Russia to the WTO, pp.297-318). See, also, Martin (1997) for an extensive analysis of the role of state trading in China's current trade regime.

phased out over periods of up to five years. It is important that these public commitments by China will be sincerely carried out, and the equalization of the competitive conditions between imports and domestic goods will be further accelerated and expanded, thereby improving the compatibility of China's trading system with the established GATT/WTO norms.

## **(2) Standards and Certification**

Another remarkable fact about China is sudden changes in her economic system, and lack of uniformity in the administration thereof, which is in conspicuous contrast with the GATT/WTO rule to the effect that *laws and ordinances should be administered uniformly in order to secure procedural transparency and predictability of outcomes*. Indeed, real examples abound in China, where not only different authorities and institutions are in charge of inspections depending on whether the products are domestically supplied or imported, but also the standards in accordance with which the products are inspected often lack transparency. Notice that the problem is not just a matter of certification standards alone, which are alleged to be applied to domestic and foreign firms without discrimination and domestic products and imports alike, but also a matter of the lack of transparency in procedures and dual inspecting authorities.<sup>30</sup> This is the area where substantial efforts by China for establishing basic conformity to the GATT/WTO rules are definitely called for.

## **(3) Import Restriction**

China's efforts since 1993 to eliminate quantitative restrictions such as quotas, import licensing requirements and open tender requirements have brought the initial long list of 1,247 restricted items down to 448. Since these remaining import restrictions are inconsistent with the GATT Article XI, China should provide a clear schedule for their complete elimination, unless and until an exceptional import restriction is made permissible by international agreement for the purpose of establishing a particular infant industry. The problem of China's remaining import restriction is further multiplied by the lack of transparency of the rules and administration thereof.

## **(4) Subsidies**

China is currently reviewing and consolidating its subsidies including low-interest state loans to facilitate the transition to a more market-oriented economy, which is also partly motivated by fiscal constraints. It is asserted that China has already eliminated all of its export subsidies and subsidies for preferential use of domestic products. Needless to say, these subsidies are banned by the Agreement on Subsidies. Prior to accession to the GATT/WTO, China will have to review more thoroughly the many subsidies still in place in the form of loans, equity investment, preferential tax treatment, etc., and to identify those that do not conform to the GATT/WTO rules.

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<sup>30</sup> Some concrete remarks will be made on automobile standards and certification in (5) below.

### **(5) Automotive Industrial Policy**

It was in July 1994 that China announced its "Automotive Industrial Policy", which is designed to establish the automotive industry as a "pillar" of the Chinese industry by the year 2010 through consolidation of companies and better exploitation of economies of scale. Needless to emphasize, every country has the right to pursue its industrial policy only to the extent that it is not incompatible with the set of rules to which the country has made a firm commitment in advance. If China wishes to accede to the GATT/WTO, therefore, China's automotive industrial policy must be in conformity to the GATT/WTO rules and its concomitant obligations. It is from this viewpoint that we comment on China's automotive industrial policy in what follows.

To begin with, China's automobile standards and certification system are stricter for imported automobiles than for domestic products. This procedural asymmetry is compounded by the fact that the certification institutions are different in that domestic automobiles are inspected by a group which consists of representatives from the Ministry of Machinery Industry and other organizations, whereas imported automobiles are inspected by the State Administration of Commodity Inspection. Another problem is the asymmetric treatment of domestic and imported automobiles in terms of the inspection items. These procedural asymmetries are likely to go against the GATT/WTO obligations to national treatment and most-favoured-nation treatment.

Furthermore, the automotive industry is required to give preference to domestic products in its parts selection, or to meet other local content requirements, in order to qualify for preferential tariff rates. These local content requirements are often included among the conditions required for granting permits to establish joint ventures. These measures are of dubious nature with reference to the Trade Related Investment Measures (TRIMs) Agreement. As a matter of fact, China has already committed to eliminate all local content requirements by the end of 1999.

Other measures in China's automotive industrial policy that seem to be problematic from the viewpoint of the GATT/WTO consistency include the following:

- (a) State Council's approval for annual automobile import volumes and types, which seems to be incompatible with the GATT Article XI prohibiting quantitative restrictions on imports;
- (b) Restrictions on the ports of import for finished automobiles, which seems to be incompatible with the GATT Article XI;
- (c) Preferential treatment such as granting of loans depending on export ratios which may possibly violate the Subsidies Agreement Article III which prohibits export subsidies.

### **(6) Protection of Intellectual Property Rights**

China's laws on intellectual property rights are already in basic harmony with the requirements set out in the TRIPs Agreement. However, they are in fact not providing sufficient protection for well-known trademarks, nor is there any law regarding protection of integrated circuit designs. Indeed, there have been many instances of intellectual property rights infringements in China, which include counterfeits of the Japanese products. Enhancements of legal and administrative frameworks, as well as more rigorous enforcement of the

laws, are definitely called for in these arenas. Another point to be noticed is that there exists a bilateral agreement between the United States and China on intellectual property rights, which was concluded under the unilateral threat of United States Special 301 Procedure. This agreement is meant to counter China's infringement of intellectual property rights through such means as confiscation of counterfeit software products and closure of associated production facilities. At present, there is no multilateral mechanism through which trade disputes between the GATT/WTO member countries and China can be resolved in a procedurally fair and transparent way. Therefore, it is understandable that such a bilateral agreement had to be sought for by default. Nevertheless, there are far too many examples in Japan's past experience with the United States suggesting that a bilateral agreement like this may easily trigger another round of disputes, which may be ever more serious than the original case. Such a danger is clearly in view in the Sino-U.S. negotiations on intellectual property rights, as the United States has continued to argue that China does not abide by the bilateral agreement.

## VI. *Concluding Remarks*

In concluding this paper which covered a rather wide area, let us keep two general observations on record.

In the first place, *conformity* of a country's domestic rules to the GATT/WTO set of procedural rules can be attained by designing and implementing an appropriate "interface mechanism" within the GATT/WTO set of procedural rules rather than invoking "structural" measures for international harmonization. Indeed, there is a clear danger that the latter measure makes harmonious co-existence of different economic systems less, rather than more, likely to materialize.

In the second place, despite superficial resemblance in several respects, China's industrial policy in general and automotive industrial policy in particular have very little in common with Japan's industrial policy during the rapid growth era.<sup>31</sup> It is true that there were two important plans towards Japan's automotive industry in the process of moving towards eventual liberalization in the 1960s: the "People's Car" concept in 1955, and the "producer group" concept in 1961. The former concept aimed for the production of a popular, low-priced minicar which could be exported with production being concentrated in one firm. The latter concept, made public by the Industrial Finance Committee of the Industrial Rationalization Council, visualized producers being classified into groups of two to three firms each, with one group for "mass production" vehicles, a second group for specialty vehicles, and a final group for minicars. However, neither of these two plans were materialized in the end. For automobiles, where product differentiation is an important strategy for interfirm competition, these plans were not incentive-compatible and thus could not solicit voluntary compliance by private firms. This is a reflection of a general pattern. *Contrary to a rather widely held view, Japan's industrial policy could be successfully implemented only when the policy design was in basic*

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<sup>31</sup> For Japan's industrial policy for automobile industry, the readers are referred to Komiya, Okuno and Suzumura (1988, Chapter 12). See, also, Odaka (1983, 1996).

conformity to private incentives.<sup>32</sup> This is a condition for implementability of industrial policy in domestic arena, whereas a condition to the similar effect in international arena is nothing other than its conformity to the GATT/WTO procedural rules. The main purpose of the present paper was precisely to bring this simple point unambiguously home.

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<sup>32</sup> One of the services rendered by the interactive mechanism for coordination, which was examined in Section III, is precisely to secure this incentive compatibility of an industrial policy initiative.

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